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Federal Income Tax on Timber

A Quick Guide for Woodland Owners

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Capital Asset and Cost Recovery

Timber Basis

Basis of Purchased Timber

Identifying Types of Forest Activity

The basis of purchased timber is its purchase cost.

Documenting the timber basis is beneficial because it (1) reduces timber sale proceeds and, thus, reduces your taxes on timber sale; (2) enables you to claim loss deduction if your timber is lost, damaged, or destroyed by casualty, theft, or condemnation; and (3) allows you to recover the costs of reforestation that you may incur.

The cost of woodland purchase should be allocated among the capital assets acquired, such as land, timber, and other property, based on its relative share of their FMV.

The best time to establish the original basis of your timber is at the time of acquisition because the timber volume and value may be readily available then. Retroactively determining timber basis may be acceptable, but the cost of doing so should be weighed against any potential tax savings.

Qualifying for the Best Tax Treatments

The basis of purchased timber includes the purchase price of the timber and other acquisition costs, such as legal fees, accounting fees, title search, and consulting forester's fees.

Document your timber basis in premerchtable timber and merchantable timber categories (such as sawtimber, pulpwood). Include both timber volume and value in the basis.

The original basis of timber may change over time through adjustments, such as a new purchase, timber growth, timber loss, or sale. The adjusted basis of timber is used to determine the gains or losses of timber sale, casualty, theft loss of timber, or condemnation.

Reporting and Tax Forms

Document and report the original basis of timber on Form T (Timber), Forest Activities Schedule, Part I. If you are not required to file Form T, you should keep it as part of your records (see page 25). Subsequent adjustments to timber basis, such as timber growth and recovery of basis from timber sale, are made in Part II of Form T.

EXAMPLE

The tract of woodland next to your property was appraised at \$40,000 (\$10,000 for the land itself and \$30,000 for 3,000 cords of pulpwood timber on it). You purchased it for a total of \$38,000. The seller gave you a \$2,000 discount because you paid in full by cash. You spent \$200 for a title search and \$800 for a consulting forester's fees. Your total cost was \$39,000 (\$38,000 + \$200 + \$800), which should be allocated between land and pulpwood timber in proportion to their FMV.

The land's basis is \$9,750 ($\$39,000 \times \$10,000/\$40,000$) and the pulpwood's basis is \$29,250 ($\$39,000 \times \$30,000/\$40,000$).



Timber Basis

Basis of Inherited Timber

Identifying Types of Forest Activity

The basis of inherited timber is the FMV of the timber on the date of the decedent's death (stepped-up basis) or the value on the alternate valuation date (6 months after the date of death).

As another option for 2010 decedents, an election enables a limited stepped-up basis, but the estate tax is eliminated entirely, regardless of the size of the estate. Such a limit is \$3 million if passed to a spouse, plus an additional \$1.3 million if passed to any other heirs.

The basis of an inherited property under the special use valuation (of Section 2032A) is the value under such method.

Your basis of land, timber, and other capital assets must be separately established.

See page 12 for retroactive determination of timber basis and the advantage of establishing basis.

Qualifying for the Best Tax Treatments

Establishing timber basis requires a determination of the timber volume and value on the date of the decedent's death.

The basis is set up by timber account (or block, typically by large commercial landowners): for example, an area within geographic boundaries, political boundaries, or management units. Keep track of timber volume as part of the timber basis.

Retain records to verify your timber basis computations.

Reporting and Tax Forms

Document the original basis of timber on Form T (Timber), Forest Activities Schedule, Part I. If you are not required to file Form T, prepare and keep it as part of your records (see page 25). Subsequent adjustments to timber basis, such as timber growth and recovery of basis from timber sale, are made on Form T, Part II.

For 2010 decedents, the estate must have elected on Form 8939 by January 17, 2012, to use the limited stepped-up basis (this option avoids the estate tax entirely).

EXAMPLE

On June 2, 1998, you inherited the woodland that has been kept in the family for generations. In 2012, you had a timber sale. Your tax preparer asked for your timber's adjusted basis to file your tax return.

You did not establish the timber basis at the time of inheritance. But, your forester was able to provide a professional report that established the timber volume and FMV on the date of the decedent's death: 800 cords of pulpwood at \$15 per cord. So your timber basis is \$12,000 (\$15 x 800 cords). Properly setting up timber basis saves taxes from the timber sales.

See IRS Publication 4895, Tax Treatment of Property Acquired From a Decedent Dying in 2010.



Timber Basis

Basis of Timber Received as a Gift

Identifying Types of Forest Activity

If the FMV of the timber at the time of the gift is equal to or more than the donor's adjusted basis, your timber basis is the donor's adjusted basis. Gift taxes paid by the donor may increase your basis by all or a portion of it, depending on the date of the gift.

If the timber's FMV at the time of the gift is less than the donor's adjusted basis, your basis is (1) the donor's adjusted basis for figuring gain when you later dispose of it or (2) the FMV on the date of the gift for figuring loss from the sale. You may have neither a gain nor loss from sale of gifted timber if you sell for more than the FMV but not for more than the donor's adjusted basis.

See the benefits of establishing basis on page 12. Also see the explanation of retroactive determination of timber basis on page 12.

Qualifying for the Best Tax Treatments

To determine the basis of gifted timber, you need to know the donor's basis, the FMV at the time of the gift, and the amount of gift taxes paid, if any.

Establishing the original basis of timber at the time of gift saves time and money because timber value and volume information may be readily available.

Reporting and Tax Forms

Document and report the original basis of timber on Form T (Timber), Forest Activities Schedule, Part I. If you are not required to file Form T, you should keep it as part of your records (see page 25).

Subsequent adjustments to timber basis, such as timber growth and recovery of basis from timber sale, are made on Form T, Part II.

EXAMPLE

In 1999, your father transferred title to you, as a gift, of a 49.5-acre woodland that had timber with an FMV of \$16,000. His timber basis was \$2,000.

Because the FMV of timber of \$16,000 is more than your father's adjusted basis of \$2,000, your original basis for the timber was \$2,000, the donor's basis.

